

General Information Letter: Income from reimbursement for medical expenses claimed as itemized deductions in a prior year may be subtracted.

August 17, 2005

Dear:

This is in response to your letter dated August 5, 2005, in which you request advice. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information, the regulation governing the issuance of letter rulings, 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department, can be accessed at the Department's website. That address is www.revenue.state.il.us/legalinformation/regs/part1200.

Although you requested a PLR, the nature of your question and the information provided require that we respond only with a GIL.

In your letter you state as follows:

This letter is to request a private letter ruling on my client's 2004 Illinois Tax filing and a review of the result reached on the LTR-402 Error Notice Response dated August 4, 2005 by Gary Doyle, Revenue Tax Specialist.

The line item in question represents a recovery of items previously deducted on a prior year's schedule A. Under ordinary conditions, the income from this item is not taxable income. It was only included in the Federal AGI because a deduction was made on Schedule A in 2003 when the qualified expense was paid. If the expense and reimbursement were made in the same year, neither income nor deduction would have been required to be reported.

Attachments:

- A - 2003 Schedule A showing \$41, 486 of expenses deducted on line 1.
- B – 2004 Federal 1040 showing the inclusion of this recovery on Line 21
- C – 2004 IL 1040 Schedule M showing subtraction of this recovery
- D- IL 2848 Power of Attorney

DEPARTMENT RESPONSE:

The starting point for calculating an individual's Illinois Income Tax liability for a given taxable year is that individual's Federal Adjusted Gross Income (AGI). Illinois Income Tax Act (IITA) Section 203(a)(1). The AGI figure is subject to certain addition and subtraction modifications in calculating the individual's Illinois base income subject to tax. IITA Section 203(a)(2). No modifications may be claimed against Federal AGI in calculating Illinois base income except for those expressly provided for by the legislature. IITA 203 (h).

Certain expenses that may be deducted federally, such as medical expenses, casualty losses or bad debts, may be deducted from adjusted gross income in determining federal taxable income. However, because the determination of Illinois base income begins with federal adjusted gross income, these deductions are not taken into account in determining the amount of income subject to Illinois income taxation. At the federal level, if one of these items, such as a casualty loss or a bad debt, is recovered in the following year, taxpayers are not required to go back and amend the prior year return. Rather, they must increase their federal adjusted gross income in the year of the recovery by the amount of the recovery.

This federal requirement caused unfairness to Illinois taxpayers for Illinois Income Tax purposes. The unfairness resulted because the taxpayer's federal adjusted gross income, and hence income subject to the Illinois income tax, was increased by the amount of the recovery of the previously federally deducted amount even though no deduction was ever allowed in the prior year for Illinois income tax purposes. In order to correct this unfairness, the Illinois Income Tax Act was amended in the late seventies to provide an Illinois subtraction (deduction) from federal adjusted gross income equal to the amount of the increase in federal income caused by this recovered item. Thus, IITA Section 203(a)(2)(I) provides for a deduction for amounts included in federal adjusted gross income under Internal Revenue Code (IRC) 111 as a recovery of an amount previously deducted in a prior tax year.

In this case, the recovered \$41,486 of medical expenses paid in 2003 was required to be included in taxpayer's Federal AGI for 2004 under IRC Section 111(a). It was therefore a proper subtraction under IITA 203(a)(2)(I), and the Department's action in disallowing it was incorrect. We are sending a copy of this correspondence to Revenue Tax Specialist Gary Doyle so that he can adjust taxpayer's account accordingly.

As stated above, this is a GIL which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a PLR which will bind the Department with respect to the application of the law to specific facts, please submit a request conforming to the requirements of 2 Ill. Adm. Code Part 1200.

Sincerely yours,

Jackson E. Donley,
Senior Counsel-Income Tax